

COMMONWEALTH OF VIRGINIA

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VIRGINIA HOUSING COMMISSION

MEETING SUMMARY

Common Interest Communities Work Group House Room C, General Assembly Building May 2, 2011, 1:30 P.M.

Members Present: Senator Mary Margaret Whipple, Delegate John Cosgrove, Melanie Thompson, Janice Burgess, Mike Inman, Chandler Scarborough, Pia Trigiani, Chip Dicks, Jerry Wright, Trisha Henshaw, Heather Gillespie, Joseph Hudgins, Tyler Craddock, Michael Toalson

Staff present: Elizabeth Palen, Jillian Malizio

I. Welcome and Call to Order

- **Senator Mary Margaret Whipple, Chair**
 - The meeting was called to order at 1:35 P.M.

II. Bank-Owned Abandoned Condominium Foreclosures

- Senator Whipple received an email from a constituent explaining there is a unit in his condominium building that has been abandoned for four years (the owner has left the state). The county is unable to foreclose on the unit because the bank is paying the county taxes. She is concerned the condominium association is affected by the abandoned unit because the association's fees are not being paid. The constituent hopes they can be included in the work of the Foreclosure Task Force and this issue can be brought forward to the attention of the Housing Commission.
- Chandler Scarborough, of Green Run Homes Association, explained that this is a big issue for condominium associations since the fees go toward insurance, grounds maintenance, etc. If one homeowner doesn't pay his share, the others will have to pay higher assessments. The association has no control over financial risk. There is no screening process for members when they buy a unit. Associations have no advance control over the credit worthiness of the buyer.
- Jerry Wright, of Community Associations Institute (CAI), described instances where the bank forecloses without a deed or trustee's deed recorded, and the associations do not get paid by the bank.
- Senator Whipple asked Mr. Wright if this is a practice that varies between banks.
- Jerry Wright responded that he didn't know but would try to find out the answer.

DELEGATE DAVID L. BULOVA
DELEGATE JOHN A. COSGROVE
DELEGATE ROSALYN R. DANCE
DELEGATE DANIEL W. MARSHALL, III
DELEGATE G. GLENN ODER

SENATOR MAMIE E. LOCKE
SENATOR JOHN C. WATKINS
SENATOR MARY MARGARET WHIPPLE

MARK K. FLYNN
T.K. SOMONATH
MELANIE S. THOMPSON

- Mike Toalson, from Home Builders Association of Virginia, asked Jerry if prior assessments are eliminated in the foreclosure process.
- Jerry Wright replied under Virginia law, the prior lien is essentially wiped out, but that does not prevent the condominium association from going after the former owners as debtors personally. When the bank becomes the owner, it is treated just like any other owner.
- Chandler Scarborough told the group that in Virginia Beach this problem has risen to epidemic proportions. More often banks are delaying recording the deed, and the association will continue to bill the former owner for the condominium fees. Banks are trying to make it look as though they don't own the property.
- Mike Toalson noted the historic foreclosure rate; in Florida one in five homes is in foreclosure. Because of the expenses involved with real estate, banks are needed to provide financing. As a former Virginia Bankers Association (VBA) employee, he is concerned that if too much of a burden is placed on banks, there will be a limited amount of available resources at the beginning of the transaction. The lack of financing is limiting sales. He feels if banks are given the power to place a lien it becomes an impediment, and that lien power will all but eliminate second mortgage loans for condominiums. This situation needs to be approached very carefully.
- Senator Whipple responded that this group will explore the problem and work to see if there are reasonable solutions.
- Melanie Thompson, a citizen member, agreed that there are quite a few foreclosures, although Virginia is not on the level of Florida. She is confused as to why the association has not done more to hold the lender accountable for the fees, because four years is an outrageous amount of time for this to continue to be a problem. She has never seen a lender not take care of the property after they have taken it into their inventory.
- Senator Whipple noted that constituent e-mails may be specific to a situation, or the situation may be happening generally.
- Tricia Henshaw, the Director of the Common Interest Communities Board, told the group that she receives many complaints from people about this issue. It is important to remember that these associations are comprised of volunteers. They are a group of people who are running an organization, but may not necessarily be knowledgeable enough to go after the bank or know what to do in this type of situation. This is the case for professional managers of associations as well as small to mid-sized associations. Maryland has passed a bill that allows liens up to \$1,200 dollars. In many associations that would make a tremendous difference.
- Janice Burgess, of the Virginia Housing Development Authority (VHDA), mentioned that there are already so many restrictions on financing condominiums. It is a catch-22 because no more than 30% of units may be delinquent on assessments. The solution might not be to place more restrictions on financing.
- Chandler Scarborough noted in Virginia Beach there are only a few communities affected because there are lower priced properties that attract first-time buyers.
- Matt Bruning, the Director of Government Relations for the VBA, agreed it is unusual for a unit to be abandoned for four years. As far as liens are concerned, the law is first in time, first in line. Moving lien preference up will add additional risk

in lending. Anything that adds cost to banks will negatively affect the ability of the housing market to rebound.

- Senator Whipple asked what happens under a normal situation, and whether the homeowner association is ultimately made whole.
- Matt Bruning replied the lien preference is structured so that taxes are paid first, and then the lender, should the property go to foreclosure. After taxes, the lender is made whole before the homeowner association.
- Joseph Hudgins, from Independent Insurance Agents of Virginia, added that once the unit is foreclosed, the bank will begin to pay assessments as they come due.
- Senator Whipple noted when the bank becomes the owner, it pays both the taxes and assessments just as any owner would.
- Pia Trigiani, of MercerTrigiani, pointed out the bank is not obligated to pay prior assessments upon taking ownership. Under the Condominium Act, tax liens are paid first, then the first deed of trust, and then any assessment lien. Under the Property Owners' Association Act, tax liens are still paid first, then the first deed of trust, and then whoever records their lien at the courthouse first wins the judgment. The problem now is that lenders are delaying foreclosure to avoid paying association fees. If lenders do foreclose, they may not pay assessments until they sell the condominium unit or house. Association assessments add value to a lender's security interest in a condominium association, but that may not be the case in other homeowner associations. Another major issue for homeowner associations is when properties are not given proper attention. For example, a homeowner on the way out the door might trash the home or leave it unsecured and it can become a blighted piece of property.
- Mike Toalson cautioned against creating a situation that would impede a future sale. The only thing worse for a condominium association than not collecting is having an abandoned unit in the property. He encouraged finding incentives for banks to take ownership of these properties.
- Senator Whipple asked Mr. Toalson how the bank would be hurt by a requirement to keep more money in escrow.
- Mike Toalson responded that lessens the number of people who can qualify for financing on the unit.
- Chandler Scarborough noted that requiring buyers to qualify for their mortgages and assessment fees is good business. Requiring that those be paid through escrow should not be an additional financial hardship.
- Melanie Thompson asked Mr. Bruning if he agrees that most underwriting guidelines already call for a homeowner to have a substantial amount of money. She feels that adding an escrow requirement would be adding unnecessarily to existing financing requirements.
- Matt Bruning replied under the national standards, requiring 20% down will be the new norm.
- Janice Burgess noted that when calculating a potential buyer's qualifications using Fannie Mae, Freddie Mac, and FHA, the amount of the current homeowner association dues is factored into consideration, just as taxes and homeowner insurance. Insurance and taxes are escrowed once per year. Homeowner association dues may be more complex, because special assessments are not taken

into consideration. An amount for special assessments could be escrowed, but the homeowner may not ultimately have to pay that fee.

- Joseph Hudgins asked if there are circumstances where the condominium association would pay the assessments.
- Mike Toalson responded one of the problems for small associations is both the amount of the assessment and the mortgage holder can change.
- Chandler Scarborough wondered how Virginia's lien priority compares to other states.
- Senator Whipple asked Heather Gillespie, the Common Interest Community Ombudsperson, to tabulate calls she has received related to the effects of associations and update the group so they can better understand the typical HOA case.

III. SB 1253; Virginia Property Owners' Association Act (Vogel, 2011)

- Senator Jill Vogel
- Angela Bell, Chief of Staff for Senator Vogel, explained a problem in the Loudon County area with a homeowner association being run by the declarant developer. The association has had problems trying to get the developer to help with the assessments.
- Pia Trigiani explained these types of cases involve a developer who retains control of the homeowner association and remains on the board even after there are a substantial number of homeowners in the community. The Condominium Act allows the developer to retain control of the association for specified periods of time. However, the Property Owners' Association Act (POA) does not address developer control and was never intended to affect developer control. Some developers have retained control until the last unit is sold. Instead, the developer should bring homeowners into the association and transition slowly. Even uniform acts do not recommend developer control provisions. Transitioning control from the developer to homeowners has always been provided for in the Condominium Act, but not in the POA. Instead the developer control issue is discussed in governing documents. However, legislation cannot modify the existing contract and therefore cannot address this case.
- Mike Inman, of CAI, has observed the lack of transition from developer to homeowners forces homeowners pool their money to hire a lawyer who will force the developer to perform properly. This illuminates the need for homeowners to take control of the association sooner. The developer's interest in retaining control is to provide continuity in architectural aspects of the properties, but that shouldn't prevent them from slowly handing control to homeowners. There are additional complaints that homes built later did not use the same standards of the original homes. However, the developer might be responding to a slowing market after the original homes were built.
- Senator Whipple explained they cannot do anything about what already exists, but they can make changes that may benefit people in the future. If there are successful transitions with condominium associations and the situation is similar with homeowner associations then it seems there should be some solution.

- Mike Toalson told the group HBAV opposes any requirement to turn over developer control. Condominium associations and homeowner associations are completely different. Under the POA, the developer is responsible for maintaining all the amenities of the association very early on and until the final lot is sold. To illustrate, in a development with 5,000 homes, if the developer were required to turn the association over to homeowners when 80% of the units sell, then 1,000 lots still need to be sold. At that point, the developer does not have any control. Most of a developer's profits are made on last few units sold. The developer needs assurance the project will be maintained properly. Every business has good actors and bad actors. In this case, the bad actor has taken advantage of the laws in Virginia, but not every developer will be a bad actor. Requiring a transfer of control of the association when a certain percentage of units has sold will put developers at risk. This will affect the scale of projects in the future, and most likely there will be several small developments rather than a large development. If this requirement is imposed there will no longer be large developments with wonderful amenities in Virginia.
- Senator Whipple asked if there might be a way for legislation to address only the bad actors.
- Mike Toalson replied the Common Interest Communities Board was set up to deal with bad actors.
- Senator Whipple responded that it is up to the legislators to define law, and the CIC Board cannot make up its own ways to deal with bad actors. She suggested they distinguish exactly what is bad actor behavior. She pointed out that they handled the situation with mortgage flipping similarly, and were able to eliminate a devious practice.
- Melanie Thompson mentioned there are five states that have a two-year deadline for developers to turn over control to homeowners.
- Mike Toalson reiterated that in order for builders to continue to develop large associations with community amenities, any restriction on a time frame to turn over control would be a hindrance. The result would be smaller developments with no amenities.
- Senator Whipple asked whether states with the two-year requirement have lost all of their large developments. She suggested they look to those states to determine whether that will indeed be the consequence of implementing a time frame to turn over control.
- Mike Inman suggested allowing a supermajority of homeowners to take a vote on whether to transfer control after two years, since the first people who will know whether the developer is being responsible are the homeowners. If the developer is being responsible and doing a nice job of building the community, the homeowners will not want to take control.
- Mike Toalson replied there is no one who has more at stake in the appearance of a development than the developer and his partners. The first part of a development buyers see is the entrance, and that first impression along with the overall appearance of the development is significant to subsequent sales. It is unusual to buy a lot and then have someone other than the developer build on that land.

- Mike Inman addressed the issue of the size and scale of properties. There are small time developers in Southeast Virginia, where 300 lots is more than the average, and those developers are not maintaining the community properly. They set the dues too low, and run out of money. It is not an epidemic, but is certainly a significant and recent trend
- Mike Toalson noted the people who made those investments are having a much more difficult time today.
- Senator Whipple suggested they think about ways they might be able to isolate bad actors. She is not interested in penalizing an entire industry, but in ensuring fair treatment. When a developer violates the norm and takes advantage of the laws of the state they need a way to handle that situation. She noted there may be times when bad actor behavior is strictly a result of the economic environment.
- Delegate Cosgrove acknowledged they cannot constitutionally have any impact on existing contracts, but they can make an effort to influence the behavior of bad actors, or make certain behavior illegal.
- Chandler Scarborough mentioned that a big concern builders have is that the homeowners will change the rules on the developer once they take control of the association. He suggested finding a middle point and creating checks and balances where the developer will not be able to adversely affect the homeowners and vice-versa.
- Angela Bell noted dual control is what Senator Vogel was trying to create with her bill.
- Senator Whipple asked for any other comments; there were none.

IV. Public Comment

- There was no public comment.

V. Adjourn

- The meeting was adjourned at 2:45 P.M.